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REPORT
No. 97-832

COMPLETED

9 PERIODIC PAYMENT SETTLEMENT TAX ACT OF 1982

SEPTEMBER 16, 1982.--Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ROSTENKOWSKI, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 5470]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 5470) to amend the Internal Revenue Code of 1954 to insure periodic payments for damages received on account of personal injuries or sickness, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This act may be cited as the "Periodic Payment Settlement Tax Act of 1982".

SEC. 2. TREATMENT OF RECIPIENT OF SETTLEMENT PERIODIC PAYMENTS.

Paragraph (2) of section 104(a) of the Internal Revenue Code of 1954 (relating to compensation for injuries or sickness) is amended by striking out "whether by suit or agreement" and inserting in lieu thereof "whether by suit or agreement and whether as lump sums or as periodic payments".

SEC. 3. TREATMENT OF ASSIGNEE-PAYOR.

(a) GENERAL RULE.—Part III of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to items specifically excluded from gross income) is amended by redesignating section 130 as section 131 and by inserting after section 129 the following new section:

"SEC. 130. CERTAIN PERSONAL INJURY LIABILITY ASSIGNMENTS.

"(a) GENERAL RULE.—Any amount received for agreeing to a qualified assignment shall not be included in gross income to the extent that such amount does not exceed the aggregate cost of any qualified funding assets.

"(b) TREATMENT OF QUALIFIED FUNDING ASSET.—In the case of any qualified funding asset—

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"(1) the basis of such asset shall be reduced by the amount excluded from gross income under subsection (a) by reason of the purhcase of such asset, and

"(2) any gain recognized on a disposition of such asset shall be treated as ordinary income.

"(c) QUALIFIED ASSIGNMENT.—For purpcses of this section, the term 'qualified assignment' means any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness—

"(1) if the assignee assumes such liability from a person who is a party to the suit or agreement, and

"(2) if—

"(A) such periodic payments are fixed and determinable as to amount and time of payment,

"(B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,

"(C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor,

"(D) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and

"(E) such periodic payments are excludable from the gross income of the recipient under section 104(a)(2).

"(d) QUALIFIED FUNDING ASSET.—For purposes of this section, the term 'qualified funding asset' menas any annuity contract or obligation of the United States if—

"(1) such annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment,

"(2) such annuity contract or obligation is designated by the taxpayer (in such manner as the Secretary shall by regulations prescribe) as being taken into account under this section with respect to such qualified assignment, and

"(3) such annuity contract or obligation is purchased by the taxpayer not more than 60 days before the date of the qualified assignment and not later than 60 days after the date of such assignment."

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 of such Code is amended by striking out the item relating to section 130 and inserting in lieu thereof the following new items:

"Sec. 130. Certain personal injury liability assignments.
"Sec. 131. Cross references to the Acts."

SEC. 4. EFFECTIVE DATE.

The amendments made by this Act shall apply to taxable years ending after December 31, 1981.

Amend the title so as to read:

A bill to amend the Internal Revenue Code of 1954 with respect to the tax treatment of periodic payments for damages received on account of personal injury or sickness.

I. SUMMARY

The bill amends Code section 104 to exclude from gross income damages for personal injuries or sickness whether paid as lump sums or as periodic payments. Also, the bill adds a new section to the Code providing that any amount received for agreeing to assume a liability for periodic payments as personal injury damages is not included in gross income to the extent it is used to purchase an annuity or a United States' obligation to cover the liability. The assignee's basis in the annuity contract or United States' obligation must be reduced by amounts that were excluded from gross income under the new provision. The provisions of the bill will be effective for taxable years ending after 1981.

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II. EXPLANATION OF THE BILL

Present Law

In general, present law (Code sec. 104) excludes from gross income the following types of compensation payments for personal injuries or sickness:

(1) certain amounts received under workmen's compensation laws (if paid for personal injuries or sickness);

(2) damages received under a suit or settlement of a claim;

(3) amounts received through accident and health insurance (unless received by an employee and either attributable to employer contributions that were not includible in the gross income of the employee, or else paid directly by the employer);

(4) pensions, annuities, or similar allowances for personal injuries or sickness resulting from active service in the armed forces of any country, the Coast and Geodetic Survey, or the Public Health Service, or a disability annuity paid under the Foreign Service Act; and

(5) amounts received as disability income by a United States employee who was injured by terrorist violence while performing official duties outside the United States.

However, to avoid a double tax benefit, an exclusion is not allowed for such compensation payments to the extent attributable to (and not exceeding) deductions allowed to the recipient as medical expenses in a prior year.

Generally, the Internal Revenue Service has ruled that damages for personal injury are excludable from gross income under section 104 whether paid as a lump sum, or paid in periodic payments out of a fund invested and owned by the tortfeasor or an insurer (see Rev. Rul. 77-230, 1977-2 C.B. 214; [1] Rev. Rul. 79-220, 1979-2 C.B. 74;[2] and Rev. Rul. 79-313, 1979-2 C.B. 75[3]). However, the exclusion of damages for personal injury does not apply to investment income generated from a lump-sum award invested by or on behalf of the taxpayer (Rev. Rul. 76-133, 1976-1 C.B. 34).

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[1] Rev. Rul. 77-230 holds that distributions from a trust established and owned by the United States under a settlement agreement stemming from an individual's suit for injuries sustained at a Government facility, and requiring payment of the individual's future medical expenses from the income or corpus of the trust, are excludable from the individual's gross income. Under the facts of the ruling, any trust assets (accumulated income or corpus) remaining on the individual's death would revert to the Government.

[2] Rev. Rul. 79-220 holds that where the insurer of a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer did not have actual or constructive receipt or economic benefit of the amount invested.

[3] Rev. Rul 79-313 holds that if, in a personal injury settlement, the insurer of a tortfeasor agrees to make 50 consecutive annual payments (increasing by 5 percent a year), the entire amount of the payments received is excludable from the recipient's gross income under section 105(a)(2). The taxpayer did not have any right to accelerate or modify the amount of payments, and the insurer was not required to set aside specific assets to secure any part of its obligation. The ruling concluded that the taxpayer did not have actual or constructive receipt, or economic benefit, of the present value of the damages.

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Reasons for Change

Despite several revenue rulings that indicate that the Internal Revenue Service considers that periodic payments as personal injury damages are excludable from the gross income of the recipient, the committee believes it would be helpful to taxpayers to provide statutory certainly in the area. Likewise, the committee believes that a person who undertakes an assignment of the liability for such payments from the person originally liable should not include amounts received for doing so in gross income if those amounts are used merely to purchase certain types of property to specifically cover the liability.

Explanation of Provisions

The bill specifically provides that the Code section 104 exclusion from gross income of damages for personal injuries or sickness applies whether the damages are paid as lump sums or as periodic payments. This provision is intended to codify, rather than change, present law. Thus, the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments. See Rev. Rul. 79-220 and Rev. Rul. 77-230.

The bill also adds a new section to the Code providing that, under certain circumstances, any amount received for agreeing to undertake an assignment of a liability to make periodic payments as personal injury damages is not included in gross income. Specifically, any amount so received will not be included in gross income to the extent it is used to purchase an annuity or an obligation of the United States if the annuity or obligation is designated (under regulations prescribed by the Secretary) to fund the periodic payments and the purchase is made within 60 days before or after the date of the assignment. For example, if an assignee receives $\$100X$ for assuming the liability and only $\$98X$ is necessary to purchase an annuity or United States' obligation to fund the required periodic payments, the assignee must report $\$2X$ as ordinary income. Likewise, this provision only applies when there is an assignment of a liability to make periodic payments as personal injury damages is the assignee assumes the liability from a person who was a party to the suit or agreement that determined the damages and if (1) the periodic payments are fixed and determinable as to amount and time of payment; (2) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient; (3) the assignee is subject to the same rights and liabilities of the person who assigned the liability; and (4) the periodic payments are excludable by the recipient as damages for personal injuries or sickness (sec. 104(a)(2)). Thus, an assignment by either the person originally liable (the tortfeasor) or by that person's insurance company generally would be covered by the new provision.

Finally, the new section added by the bill requires that the assignee's basis in the annuity contract (i.e., the investment in the contract for purposes of Code sec. 72) or the United States' obligation be reduced by amounts that were excluded from gross income under the new provision. Thus, under the example above, if the as-

signee purchases an annuity for the amount necessary to fund the periodic payments (98*X*), the basis of the annuity will be reduced by $98*X* under the new provision. Also, any gain recognized on the disposition of either will be ordinary income. Although the assignee will have to include any amounts disbursed from the annuity or United States' obligation in gross income, the assignee will also be entitled to deduct the full amount when it is periodically paid as personal injury damages.

Effective Date

The provisions of the bill will be effective for taxable years ending after 1981.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget effects

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made about the effect on the budget of this bill, H.R. 5470. The committee estimates that the provisions contained in the bill, H.R. 5470, as amended, will have a negligible revenue impact.

The Treasury Department agrees with this statement.

Vote of the committee

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made about the vote of the committee on the motion to report the bill as amended. The bill, H.R. 5470, as amended was ordered favorably reported by voice vote.

IV. OTHER MATTERS TO BE DISCUSSED UNDER HOUSE RULES

In compliance with clauses 3(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made with respect to the committee action on H.R. 5470, as amended.

Oversight findings

With respect to subdivision (A) of clause 2(l)(3) (relating to oversight findings), it was the result of the committee's oversight activities with respect to the tax treatment of income from periodic payments relating to personal injury damages that the committee concluded that it is appropriate to enact the provisions contained in the bill.

The Subcommittee on Select Revenue Measures held a hearing on June 14, 1982, and ordered the bill favorably reported by voice vote on July 12, 1982. The Subcommittee transmitted a report to the full committee on September 10, 1982.

New budget authority and tax expenditures

With respect to subdivision (B) of clause 2(l)(3), after consultation with the Director of the Congressional Budget Office, the commit-

tee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

Consultation with congressional budget officials on budget estimates

With respect to subdivision (C) of clause 2(l)(3), the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated in part III of this report) and submitted the following statement:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: In accordance with the Budget Act, the Congressional Budget Office has examined H.R. 5470, the Periodic Payment Settlement Act of 1982. This bill excludes from gross income damages for personal injuries or sickness whether paid as lump sums or as periodic payments.

This bill does not provide for any new budget authority or any new or increased tax expenditures.

In accordance with Section 403 of the Budget Act, the Congressional Budget Office estimates that the bill will have a negligible effect on budget receipts.

Sincerely,

RAYMOND SCHEPPACH
(For Alice M. Rivlin, Director)

Oversight by Committee on Government Operations

With respect to subdivision (D) of clause 2(l)(3), the committee advises that no oversight findings or recommendations have been submitted to the committee by the Committee on Government Operations regarding the subject matter of this bill.

Inflationary impact

In compliance with clause 2(l)(4), the committee states that the enactment of this bill is not expected to have an inflationary impact on prices and costs in the operation of the national economy.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

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PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

Sec. 101. Certain death benefits.

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Sec. 129. Dependent care assistance programs.
[Sec. 130. Cross references to other Acts.]
Sec. 130. Certain personal injury liability assignments.
Sec. 131. Cross references to other Acts.

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SEC. 104. COMPENSATION FOR INJURIES OR SICKNESS.

(a) IN GENERAL.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement *and whether as lump sums or as periodic payments*) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer);

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 808 of the Foreign Service Act of 1980; and

(5) amounts received by an individual as disability income attributable to injuries incurred as a direct result of a violent attack which the Secretary of State determines to be a terrorist attack and which occurred while such individual was an employee of the United States engaged in the performance of his official duties outside the United States.

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on

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behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee.

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SEC. 130. CERTAIN PERSONAL INJURY LIABILITY ASSIGNMENTS.

(a) GENERAL RULE.—Any amount received for agreeing to a qualified assignment shall not be included in gross income to the extent that such amount does not exceed the aggregate cost of any qualified funding assets.

(b) TREATMENT OF QUALIFIED FUNDING ASSET.—In the case of any qualified funding asset—

(1) the basis of such asset shall be reduced by the amount excluded from gross income under subsection (a) by reason of the purchase of such asset, and

(2) any gain recognized on a disposition of such asset shall be treated as ordinary income.

(c) QUALIFIED ASSIGNMENT.—For purposes of this section, the term "qualified assignment" means any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness—

(1) if the assignee assumes such liability from a person who is a party to the suit or agreement, and

(2) if—

(A) such periodic payments are fixed and determinable as to amount and time of payment,

(B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,

(C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor,

(D) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and

(E) such periodic payments are excludable from the gross income of the recipient under section 104(a)(2).

(d) QUALIFIED FUNDING ASSET.—For purposes of this section, the term "qualified funding asset" means any annuity contract or obligation of the United States if—

(1) such annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment,

(2) such annuity contract or obligation is designated by the taxpayer (in such manner as the Secretary shall by regulations prescribe) as being taken into account under this section with respect to such qualified assignment, and

(3) such annuity contract or obligation is purchased by the taxpayer not more than 60 days before the date of the qualified assignment and not later than 60 days after the date of such assignment.

SEC. [130.] *131.* CROSS REFERENCES TO OTHER ACTS.

(a) For exemption of—

(1) Allowances and expenditures to meet losses sustained by persons serving the United States abroad, due to appreciation of foreign currencies, see section 5943 of title 5, United States Code.

(2) Amounts credited to the Maritime Administration under section 9(b)(6) of the Merchant Ship Sales Act of 1946, see section 9(c)(1) of that Act (50 U.S.C. App. 1742).

(3) Benefits under laws administered by the Veterans' Administration, see section 3101 of title 38, United States Code.

(4) Earnings of ship contractors deposited in special reserve funds, see section 607(d) of the Merchant Marine Act, 1936 (46 U.S.C. 1177).

(5) Income derived from Federal Reserve banks, including capital stock and surplus, see section 7 of the Federal Reserve Act (12 U.S.C. 531).

(6) Railroad retirement annuities and pensions, see section 12 of the Railroad Retirement Act of 1935 (45 U.S.C. 2281).

(7) Railroad unemployment benefits which are not includible in gross income under section 85, see section 2(e) of the Railroad Unemployment Insurance Act (45 U.S.C. 352).

(8) Special pensions of persons on Army and Navy medal of honor roll, see 38 U.S.C. 562(a)–(c).

(b) For extension of military income-tax-exemption benefits to commissioned officers of Public Health Service in certain circumstances, see section 212 of the Public Health Service Act (42 U.S.C. 213).

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